ALTERNATIVE INVESTING

Do Hedge Funds Add Value?

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If an investor can find an asset that is uncorrelated with his or her portfolio and has a positive expected return, that asset may be very valuable at improving the risk-adjusted return of the entire portfolio. But investors must look cautiously to find hedge funds with such characteristics.

The broad universe of hedge funds might be more correlated (with markets and each other) than many think. Although some evidence exists of lags in mark-to-market pricing, little evidence exists of added value, net of market exposures and fees, at the aggregate level for hedge funds.

Our results do not indicate that investors should not invest in hedge funds. If investors can identify hedge funds that actually accomplish the twin goals of positive expected returns and diversification, then they should consider investing in them. Our results do indicate, however, that hedge funds as a whole are not as attractive as other studies purport them to be.

Some studies claim that by investing in one of each hedge fund, investors can expect wonderful results. We do not understand why anyone would support such a strategy for a skill-based asset. Doing so means the world is idyllic: Every manager has skill. Why would anyone think that?

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